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TO : DEPARTMENT OF STATE

INFO: PARIS

FROM : AMEMBASSY, ROME

DATE: May 19, 1967

SUBJECT : CIVAIR: Third Session of US-Italy Negotiations in Rome, May 5, 1967

REF : Rome A-1011

Attached as Enclosure 1 to this airgram is the Embassy's informal record of the third session of the resumed US-Italy Civil Aviation negotiations in Rome, May 5, 1967.

REINHARDT

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Enclosure 1
From: Rome A-1064

THIRD SESSION - MAY 5, 10:20 AM

NOTE: General Santini was absent from the Italian Delegation.

Ambassador Capomazza: Good morning. If you would like to commence we are ready.

Mr. Loy: Mr. Ambassador, at our last session we were continuing the discussion of a possible route exchange in a new agreement, and after a considerable amount of discussion you presented us with an oral proposal which, as I said then and repeat now, we consider helpful and a useful step by you in that it sorted out from a multiplicity of requests and options and routings, a more limited number that you indicated were of primary interest to Italy and to the Italian carrier.

We have analyzed that proposal with some care in the relatively short time we had to consider the proposal. It is quite clear to me that while we have no question at all that you consider your proposal at the last meeting a great step forward toward a solution, the US delegation has very great difficulties with the proposal.

I would like to spend a moment to tell you how we look at the proposal and what we mean when we say it is better only in comparison with the prior proposals. It still causes us to puzzle how to move these discussions forward.

First, letme say that we have spent some time to evaluate the proposal. It is one that is susceptible to evaluation. I can only be frank and say that we have not done so with the total precision we would have liked to apply, but nevertheless the proposal in form is susceptible to evaluation and we have evaluated it as best we could.

In the aggregate, based on assumptions that range from the conservative to the realistic and that are not padded, the revenues the Italian carrier could derive from the route would amount to something in the neighborhood of $84 million. When you break that down, you would find roughly that the routeswe have called A (London-New York), B(Lisbon-New York) and F (via Boston to Chicago), -- those three together would in 1967 have a value in the neighborhood of $50 million. Routes C (via Paris-Atlanta-Dallas-and beyond to Mexico) and D (Lisbon-Miami-Panama) would together fall in the range of $14.5 million. Route E (via Montreal-Los Angeles-San Francisco-and beyond to Tokyo) would have a value just short of $20 million.

That figure compares with roughly $37 million in 1965 of Italian carrier revenues, and the increase is accounted for by two things: first, a substantial increase in revenues derivable by the Italian carrier by growth of the market between 1965 and 1967, this growth factor having been applied to presently operated routes; secondly, by the new routes that are proposed to be added.

Now, I might say that we have taken the US route request that we tabled back in

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Washington and we have evaluated it on the same basis. In other words, it was brought up to 1967 for the growth factor. We find that value in the neighborhood of $63 million. I might say to accentuate the point that that figure includes the route request we made that you have indicated troubled you so greatly - the routes to East and South Africa and to Australia.

Now, this presents us with a very real problem. We are prepared to discuss this at greater length, but at the moment I just want to outline the problems we have. We are under instructions to make a route exchange which is economically balanced, and the proposal you made in the last session, compared with the proposal we made in Washington, is in our view seriously imbalanced. Therefore, that is what we mean when we say that the proposal you made last Wednesday - and I assure you that we value the fact that it was made as an effort to move forward - doesn't solve our problem. I am aware that you indicated that you wonder whether a mathematical evaluation is really the way to go about this - but let me assure you that it is the way we have gone about it with other countries, and we don't know how else to go about it. And we haven't understood you to have made a proposal for an alternative approach we could deal with.

We are prepared to meet your needs as best we can. We recognize that our method of evaluation was not handed down as Holy Writ. One could discuss at some length how to go about this. But we have no doubt that the proposal before us is imbalanced in your favor, and we cannot make a deal on that basis. We are prepared to indicate some of the reasons the imbalance exists, and they really are not all that subtle.

First: with respect to intermediate rights, the Italians enjoy an advantage over us because of the simple geographical fact that the intermediates give the Italians access to a long haul Atlantic segment. This factor is part of the new proposal as well.

Second: in this proposal, service from two large West Coast cities to Tokyo is contemplated. Tokyo is not just a point on the globe; it is <u>the</u> key to the Orient (along with Hong Kong). Traffic between the US and Tokyo is enormous both in numbers and in value, particularly in value due to the distance involved and due to the fare structure in that area. Anybody operating in that market has access to the kind of routes that airlines particularly like: long haul and thick. It does not take a very sharp pencil to figure out the advantages of a Rome-Montreal-West Coast-Tokyo route. Included in that route are two services of some length and some strength: Montreal-Los Angeles and Montreal-San Francisco.

Third: Another element in this disparity arises from adding on top of what has already been discussed the values of services derived from three new routes: Atlanta-Dallas, Miami, Mexican rights beyond Dallas, and Panama beyond Miami. These are markets of varying sizes and are sometimes hard to estimate - for example, the Atlanta-Mexico segment. We know better and have a good feeling for estimating Dallas-Mexico and Miami-Panama.

So that with respect to values, we have to say that your proposal in its entirety

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seems to us to throw the agreement totally out of balance, and it is therefore unacceptable. I might say here that I have so far not said anything about the composition of traffic - we have discussed this sort of thing before - but we have tried to estimate third and fourth freedom composition as compared to fifth freedom composition on these routes. While our figures on that are not final, we feel all the beyond would involve extremely heavy fifth freedom elements.

One more thought: One of the things we are having difficulty with here and that has troubled us, is that you have indicated your problem with the present agreement which you find as imbalanced as we find your proposal. You have now two different times made proposals you have asked us to consider - but in both cases you have really not accompanied them by any exposition of why you think the result would be a fair agreement which would give some sort of commercial or economic balance to this commercial-economic relationship. We have had to conclude that if you made a proposal such as this, and tried to evaluate the implications of it, you must have come up with thoughts similar to those I have expressed. So maybe you have additional insights or views as to why you think your proposal makes economic or commercial sense. I would be interested to hear such views, because we feel this route exchange would not be in our interest to enter into. That is about all I can say at this moment about the specific proposal you put forth on Wednesday.

Ambassador Capomazza: Gentlemen, I am glad to find out that you like the climate and life in Rome and are choosing methods that will keep us in Rome for the next few months. This seems to me to be the method that seems most cherished by the US delegation, so I suppose we will have to follow it.

It may appear polemical when I say definitely that Alitalia is a more efficient carrier than many others that operate in competition with us. I said this the day before yesterday, but perhaps you did not fully understand me. What I was driving at was that although you may have followed the same dollar method with other countries, many of them do not have the same beyond rights to offer you. Even Germany, Paris and London provide beyond points that are not as interesting as those we have to offer. So if, I repeat, for balancing dollar values with those countries who have not as much to offer you have given more points, it seems that only Alitalia can make twice as much revenue out of fewer points. You haven't given one good argument to dispute this point. Without saying the US carriers are not efficient, why is it they fly around the world and only make $63 million, while we would make $84 million with three or four routes?

We can't make any representation of what its worth, but if I told you that we think your lines are worth hundreds of millions, it would make no difference because we don't know how frequently or where they would go. But we must feel that when their operations cover practically the whole world and are run by powerful US airlines they must bring more revenue than that. So we would like to know how you break down this $63 million that includes the South African and Australian routes which we don't want to accede to.

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We know the argument of the rich market, but there are limits. Even if your plane goes to a poor market, it is carrying rich passengers. These passengers do not like to go around the world like Sputniks without stopping anywhere, and one of the nicest things we offer is a place for them to stop on the way.

Let me be clear about this: I am not going to be more specific and there will be no more offers on our part until we hear more on your part.

I'd like to say another thing. When I asked Alitalia for calculations on what your lines would amount to and to make a map, they said this would be hard to do without knowing which points are to be served, and without these it would be hard to calculate. But this is a waste of time. What we are trying to do is to match specifications against non-specifications, this is the agreement we are trying to make.

Mr. Loy: Mr. Ambassador, I don't really believe your problem is all that great. To charge that what we are doing is specifications versus non-specifications is nonsense. It would take Alitalia about ten minutes to compute, on the same basis that we have computed, the value of our route request. We are talking about traffic flows where known, and estimates where there is no present service. Operating costs and efficiency need not enter the picture. That would only complicate matters.

During our Washington session, General Santini made some comments as to what he assumed were US revenues derived from the Italian agreement. While we did not entirely agree with his figures, we did not dispute them and we are prepared to accept them. Those were figures for 1965. We are not operating in the dark. We have a history of 20 years of operations in Italy. In terms both of the pattern of routes and of passengers and dollars, those operations are susceptible to very precise historical evaluation. Our route proposal does nothing more than put in more precise form - at your request - what we have already been operating, and the specific points of Bangkok-and Hong Kong and the points in East and South Africa and Australia that have not been served at all. For the latter you would have to make an estimate. With the former, you just have to bring 1965 figures up to date.

Now, I don't have any reluctance to indicate to you roughly the way we arrive at our $63 million figure. It is essentially composed of three parts: 1) $40.8 million for traffic between Italy and the US; 2) $6.5 million or a little less for intermediate points; 3) $15.5 million for beyond points, including all the requests we have made -- those we now serve, and in addition those we are not yet serving. In the latter category we have added a value to the round-the-world service through Rome that we have not been serving to date. Quite frankly, it would be much easier for you to compute our values than for us to compute yours, because ours are so fundamentally based on historical operations.

I don't know whether our carriers are efficient or inefficient, but we don't have to

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speculate too much when we have 20 years of operating history on which to base our calculations. Often we have a far smaller statistical base than we are privileged to work with in this case.

Mr. Rodriguez points out that the figures I have been using are for 1967, derived by adding growth factors to prior figures. The same factors were used in our evaluation of the Italian proposal.

Let me add, and maybe this is repetition, you say specifications versus unspecifications and I say that is not the case.

Ambassador Capomazza: You said "nonsense".

Mr. Loy: I meant "not the case."

There is no question that we are talking about more points than you are, but it does not do any good to pretend that Rome-Dhahran or Rome-Ankara or Rome-Tehran operations are in any sense equivalent, ought to be weighed against, or ought to be considered in the same light as Dallas-Mexico or San Francisco-Tokyo. That seems to us to be plain. They are markets of different size, length, and thickness. You could add up all our present beyond rights and in terms of present commercial values they would not match either the two routes to the South or the two routes to the West that you have asked for.

So I think we are both talking about specifics. You are unprecise about what happens beyond Tokyo. But that is not the part I want to dwell on. The point is we are both talking about route proposals that have points with values, and the values of some points are radically different from the values of others.

Let me add another thought or two. It is hard to know really how to make a between our agreement with you and our agreement with certain other coun ght say that some of ours we consider out of date and we might like to do som about them.

You mention that beyond London are the fogs of the North. Quite aside from the fact that we serve many points b[illegible] (I don't know now the values of them but I do know something about the va[illegible] the UK agreement). Besides London which is itself as important as Rome, we get [illegible] the two key points in the Pacific areas - Hong Kong - which is after Tokyo the principal point of that area and has tremendous commercial interest. We want to serve it and we do from more than two directions and we obviously paid for that right. In addition, out of the UK agreement we receive access to the fantastically important Caribbean area, specifically the Bahamas and Bermuda, as well as more minor islands such as the Leeward and Windward Islands. I believe that in the summer, which is the off season, we have 150 weekly frequencies to the Bahamas. I don't know what all you can say about these comparisons, except that with the UK last year we spent some time updating our agreement, meeting our greatest needs and adding equivalent values to both sides. We obtained in the UK agreement a critical point in Europe, a critical point in the Far East and access

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to critical points in the Caribbean. We did all that on the same sort of exchange basis as here. I bring all this up to show that it is difficult to make comparisons, but in all cases we have to go on the basis of a balanced route exchange.

One more thought. You sort of wondered if we are trying to stretch things in Rome because we like it here. For us, focusing on, concentrating on, and working on the problem of value is not a dilatory tactic - its what we think we've got to do to make a deal. We have worked diligently on this problem because we think it is essential; we don't think it is a delaying tactic on our part. We like to be in Rome, but we would like it better if we were not negotiating every day. I guess that leads me logically to suggest that my idea of how to proceed would be to ask you to tell us whether our view is sound and right, or is wrong and not correctly done; that would be one way to come closer to what we would see as the way to an agreement.

Ambassador Capomazza: I think we ought to have a small recess, but before I would like to point out a few things. I don't think you are trying to delay, but there are ways and ways of doing things, and you seem to have chosen the longest way. Without wanting to comment on the figures that are difficult to evaluate, I would like to say a few things about the figures you have given. It is true that the market between the US and Japan is not to be compared with Rome-Tehran. I will go as far as that. But tell me how this very valuable market is so much more valuable to us than it is to you? How is it that for us it is worth $20 million but in your package, $15.5 million includes everything beyond Rome. Your line is fed by so many more intermediate points and carriers so much more between Tokyo and the US, but it is only worth three, or four or five million dollars. If I am making a mistake please correct me.

You brought up Dhahran. It is not New York, but it is not negligible as a beyond point from Rome. Your Americans in Dhahran come to Rome for vacations. If you think going beyond is of such limited importance to you, if you do not consider the importance of having beyond Rome in the route schedule, are you suggesting a third and fourth freedom agreement leaving out all beyonds? We are ready to consider that.

We understand the importance of the Bahamas and Bermuda and London, but we cannot accept your figures. You talk of history but these are all new lines. Let us stop now for a moment and perhaps have a Vermouth.

(15 minute recess)

Ambassador Capomazza: Gentlemen. Please note that we are being asked all the time to make new proposals. So far we have received not one proposal from you after four weeks in Washington. I am not going to follow this procedure indefinitely - this is what I consider the long way. Whatever I could say in 20 words I could say in 500, but I always choose 20.

Through the observations of the Assistant Secretary we note the emphasis on market, the composition of traffic and the origin of traffic - the famous 60 percent of US nationals flying through the world. I will ask Dr. Malintoppi to talk later about this and to explain international law on the subject.

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I will also point out one thing that has also to do with composition from our point of view. When you seem eager to gain as many points as you can, you forget that Alitalia flies on US wings- Alitalia has ordered from $600/800 million of US planes that, as I have said before, are not for use between Frascati and Rome. The US aircraft industry is going to lose even if US carriers win, if we see our operations limited in the future.

There must also be some political considerations in all this, because it is an agreement between governments and not companies.

As for the evaluations, let me tell you we have reached the starting point. Give us points and frequencies and we will give you a serious evaluation - otherwise all we can do is throw figures on the table as you have. Otherwise please accept that we are discussing specificities against unspecificities. Coming down to the $15.5 million represented by your future rights beyond, we would like to have them broken down. We would be curious to know how you make this exercise.

Another element which I will ask Dr. Caruso to deal with is the element of third and fourth freedom you bring up with your agreement with the UK. We've taken this up from the beginning. Dr. Caruso will talk about the UK and intermediates and the beyond Rome rights that have so little value to you. But when you bring someone (from beyond Rome) to Rome, he will also fly to New York.

You have talked about the value of the route to Tokyo, but you forget what I have repeated so many times: we would have few frequencies, and we could even accept predetermination on that line so long as it were not unilateral. Otherwise you must simply content yourself with the thought that Alitalia will not fly 20 times per week. The stretch from the West Coast to Tokyo is rather long -- even Magellan had to stop somewhere. We may have to ask for a stop in Honolulu if you make it so hard for us. And now Dr. Caruso.

Dr. Caruso: Evaluation can be done in an infinite number of ways - in dollars, by considering the possible routes offered, or by many other systems. I would like to commence with the method proposed by the US delegation on a point made by Mr. Loy, to give an idea of the importance of the points to be conceded Alitalia by the US. Take London. In dollars, according to the US delegation, we should consider the importance of the market of that point. But that is not enough. The US delegation gives values in its evaluations according to the importance of a point, but according to the Italian delegation there is a series of other factors. We must take account not only of the market but above all of the situation of that point, not only the competitive services but the frequencies we are allowed to employ. In the case of US and UK carriers, the value of London is greater than for Alitalia because these US and fourth freedom carriers have the best chance of getting traffic and they have an enormous number of frequencies. The value for Alitalia is less than the US delegation wants to give it, because we do not enjoy the same elements as the US and UK carriers in that market - it is much lower for us.

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The value in dollars requires, in the case of London or any other stop, that you deal with the value of the market as a whole while eliminating other factors. But in the case of London, for example, I must repeat what the US delegation already knows: Alitalia cannot make more than 9 frequencies weekly. Therefore, if you think that the value of London can be determined based on the value of the market, we are not on the right road to a real evaluation.

I can say the same for all the other points asked by Italy. For example, Los Angeles-Tokyo. Let me say that we know very well the market value of the West Coast-Japan market, but to repeat, we must consider what opportunities Alitalia has to operate in that sector. Alitalia, flying from the West Coast towards Japan, gets farther away from its traditional bases into unknown territory. We are ready to try to make a dollar evaluation but we cannot do it on the value of the total market. Rather we must consider our possibilities. We must correlate the possibilities of our carriers with the carriers of the two countries involved, with a number of third and fourth freedom frequencies and the tiny number Alitalia could operate - there is really no comparison. You must take this into account. You could say $40 million or $5 million but you have not shown how it works.

Now, the Italian carrier has three points in the US (New York, Boston, Chicago) leaving Italy from Rome and Milan. The US carriers leave the US from an infinite number of points to arrive at Rome and Milan. Therefore the possibilities for traffic - not to speak of revenues - for US carriers are much greater than for Alitalia. The US carriers represent in world traffic a huge complex. The fact that in serving all these US points, they still get less revenues from them than Alitalia does, shows that the problem is not one of real revenue, since these do not measure the enormous possibilities conceded by allowing flights from all these points to Rome. This goes beyond revenues because it offers the possibility to the American carriers to distribute their traffic for all oriental points.

The US carriers also have much greater possibilities than Alitalia to serve all those points in the US. There is much to be corrected here in order to have equivalence for these points.

As far as fifth freedom rights are concerned, we are not in agreement on the composition for traffic. As Italian delegations have said many times in the past, we do not agree with your interpretation of these principles. When a passenger arrives in Italy, he has finished the third and fourth freedom part of his trip, whether his final destination is Italy or whether he has come here for a stopover. So we give different values than you do for these routes.

So far as intermediate stops are concerned, the US carriers make more intermediate stops than Alitalia does. Therefore, the added value of the length of Alitalia's routes is made up for by the increased number of points served by Alitalia.

So far as beyond rights are concerned, the problem is simple. Italy has no beyond points. There is no point in repeating here the number of points the US carriers have beyond Italy. So, for fifth freedom rights beyond, there is no comparison since

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we have none at all. In conclusion, third and fourth freedom possibilities are much greater for the US. Fifth freedom intermediate possibilities are balanced because of the balance of length of routes versus number of points and because of third country limitations on Alitalia. For fifth freedom possibilities there is no comparison.

Prof. Malintoppi: (Summary of comments):

Prof. Malintoppi emphasized that the two delegations are engaged in negotiating an agreement notebetween aviation companies but between states. Thus, the rights granted by each side are essentially political rights. Applying this principle to the geographical areas of the two states, Prof. Malintoppi said that what is to be exchanged in this Civil Aviation Agreement are channels of traffic between two states, not between a large geographic area and a small geographic area. The starting point for exchange of traffic rights must be establishment of reciprocity between two countries and not comparative geography.

With regard to choice of points of departure in the respective states, Mr. Malintoppi argued that first and foremost is the principle of equality, and the impact of the geographical area of the two states is nothing but a correction on the grounds of equity. Thus, one country's freedom to choose the points of departure in its own country is not a de facto statement but a starting point for applying the political principle of reciprocity.

Ambassador Capomazza: Our luncheon schedule makes an interruption necessary. Perhaps we should discuss when and whether we should meet again.

Mr. Loy: Mr. Ambassador in view of your injunction as to time, I will not say anything now about Dr. Caruso's and Prof. Malintoppi's interventions, except that they were both useful and were a contribution to the discussion to which I do wish to refer at our next meeting. I appreciate the thoughtfulness of their discussions. As for the next meeting I propose 10:30 Monday morning.

Ambassador Capomazza: That will be all right with us.

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